

**DEPARTMENT OF STATE REVENUE  
SUPPLEMENTAL LETTER OF FINDINGS NUMBER 99-0248  
Gross Income Tax  
For the Years 1995, 1996, 1997**

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**ISSUE**

**I. Gross Income Tax-** Gross Receipts

**Authority:** 26 USC Sec.61 (a), IC 6-2.1-2-2, IC 6-2.1-4-2, 45 IAC 1-1-17, Indiana Department of State Revenue v. Northern Indiana Steel Supply Company, 388 N.E. 2<sup>nd</sup> 596 (Ind. App.) 1979.

The taxpayer protests the inclusion of certain income in gross receipts.

**II. Tax Administration** – Abatement of Penalty

**Authority:** IC 6-8.1-10-2.1, IC 6-8.1-10-2.1(d), 45 IAC 15-11-2(b), 45 IAC 15-11-2 (c).

The taxpayer protests the imposition of the negligence penalty.

**STATEMENT OF FACTS**

The taxpayer owned and operated an Indiana television station. After a routine audit, the Indiana Department of Revenue, hereinafter referred to as the “department,” assessed additional income tax. The taxpayer protested the assessment and a hearing was held on the taxpayer's alleged constructive receipt of income and penalty. A Letter of Findings was issued on October 24, 2002 denying the protest. The taxpayer requested a rehearing and the rehearing was granted.

**1. Gross Income Tax:** Gross Receipts

**Discussion**

The taxpayer owned and operated an Indiana television station. When the taxpayer agreed to sell an advertisement or commercial, it sent an invoice to the advertising agency involved. That invoice showed the gross cost of the advertisement, the advertising agency commission of fifteen per cent (15%) and the net billing for the commercial. The advertising agent paid the taxpayer by check. The advertisers pay the

advertising agency's percentage of the bill directly to the advertising agency. The taxpayer never received a check or other monetary compensation for the advertising agency commission. Due to its accrual accounting method, the taxpayer recorded the total price of the advertisement in its books, with separate entries for the advertising agency commission and the actual cost for the airing of the commercial. The taxpayer reported the entire amount of the income as income on its federal income tax return and deducted the amount of the commissions under "other income." The department imposed gross income tax on the advertising agency commissions. The taxpayer protested this assessment.

IC 6-2.1-2-2 imposes a gross income tax on the gross income or gross receipts of taxpayers domiciled in Indiana. The term "gross receipts" is clarified in the applicable 1988 Regulations at 45 IAC 1-1-17 as follows:

Gross Income Defined. "Gross income" and "gross receipts" mean the entire amount of gross income received by a taxpayer. This includes all income actually or constructively received, i.e., monies credited to the taxpayer by his creditors, or paid to his creditors on his behalf by a third party.

Amounts received or credited include not only cash and checks but notes or other property of any value or kind, services of any value or kind and receipts in any form received by or credited to the taxpayer in lieu of cash.

The taxpayer is required to report his entire gross income in order to determine its taxability. From this amount he may take deductions as allowed under the Act.

The taxpayer contends that it never actually or constructively received the money or any other services, receipts in kind or any other type of credit for the advertising agency's fifteen per cent (15%) of the total billing. Therefore, the advertising agency fee did not qualify as gross receipts subject to gross income tax.

In accordance with its accrual accounting method, the taxpayer actually recorded the total amount as a receipt. Clearly, this income was credited to the taxpayer and the taxpayer received the benefits of income in its books and balance sheets. The taxpayer also held both the advertiser and the agency jointly and severally liable for any outstanding bill. The taxpayer's statement that it would forbear from attempting to collect the commission does not negate the fact that based upon the invoice, it has the right to collect the commission. Further, the taxpayer reported the total amount on its federal adjusted gross income tax return as "gross income" and took a deduction for commissions paid to advertising agencies.

For purposes of the federal adjusted gross income tax, "gross income" is defined at 26 USC Sec.61 (a) that states in part:

Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

(1) Compensation for services, including fees, commissions, fringe benefits, and similar items. . .

The taxpayer analyzed the subject income for federal adjusted gross income tax purposes and determined that its gross income included the protested amounts. It is clear that the protested amounts were not actually received, therefore they must have been constructively received. The taxpayer was not subject to federal or state adjusted gross income tax on these constructive receipts because those laws allow a deduction under “business expenses” for commissions.

The definitions of the term “gross income” for both the Indiana gross income tax and the federal and state adjusted gross income tax include “all income” received. It is disingenuous for the taxpayer to argue that “all income” for gross income tax purposes doesn’t include income that is included in “all income” for adjusted gross income tax purposes. The credited amounts are either part of “all income” or they aren’t. The difference appears to be that the protested income is deductible for adjusted gross income tax purposes and not deductible for gross income tax purposes. That is not a valid method for determining if monies were constructively received.

The taxpayer cites the case Indiana Department of State Revenue v. Northern Indiana Steel Supply Company, 388 N.E. 2<sup>nd</sup> 596 (Ind. App.) 1979 in support of its contention that the contested receipts did not constitute income subject to the gross income tax. In the cited case, the Northern Indiana Steel Supply Company sold two cranes, magnets, and a mobile office with furniture to another company. The cranes and magnets were subject to liabilities. The negotiated purchase price was \$405,319.80. The purchaser satisfied the total purchase price by assuming the liabilities in the amount of \$383,163.50 and paid the seller cash in the amount of \$22,156.30. The Indiana Department of Revenue attempted to assess gross income tax on the value of the assumption of the liabilities. In holding that only the cash received was subject to the gross income tax, the Court stated at page 599 as follows:

The taxing statute empowers the Department to tax payment of a taxpayer’s debts by a third party *for his direct benefit*. In this case, the purchaser paid the liens for its own direct benefit. The fact that Northern was thereupon freed as surety on the obligations constituted at most an incidental or indirect benefit under the taxing statute.

This case is distinguishable from the taxpayer’s situation. The taxpayer does receive direct benefits from this method of accounting for the funds. For example, the taxpayer is still liable for the amounts paid to the advertising agency at the time they are to be paid by the third party.

The advertising agency fees recorded in the taxpayer's books were constructively received gross income since a third party satisfied the taxpayer's obligation to the advertising agency and the taxpayer declared them as such for federal and state adjusted gross income tax purposes. As such, the recorded amounts were gross income as contemplated by the law and regulation. The law provided for certain deductions from gross income for tax purposes such as a deduction for bad debts pursuant to IC 6-2.1-4-2. However, the gross income tax law provides no deduction for commissions.

The department properly imposed gross income tax on the commissions.

### **Finding**

The taxpayer's protest is denied.

## **2. Tax Administration:** Abatement of Penalty

### **Discussion**

The taxpayer also protests the imposition of the ten percent (10%) negligence penalty pursuant to IC 6-8.1-10-2.1. Negligence is defined at 45 IAC 15-11-2(b) as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case-by-case basis according to the facts and circumstances of each taxpayer." Id.

IC 6-8.1-10-2.1(d) allows the department to waive the penalty upon a showing that the failure to pay the deficiency was based on "reasonable cause and not due to willful neglect." Departmental regulation 45 IAC 15-11-2 (c) requires that in order to establish "reasonable cause," the taxpayer must demonstrate that it "exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed. . . ."

The legal issue involved in this protest is a difficult and fact sensitive one. The taxpayer sustained its burden in establishing that it was not negligent in failing to pay the assessed gross income tax.

### **Finding**

The taxpayer's protest to the imposition of the penalty is sustained.